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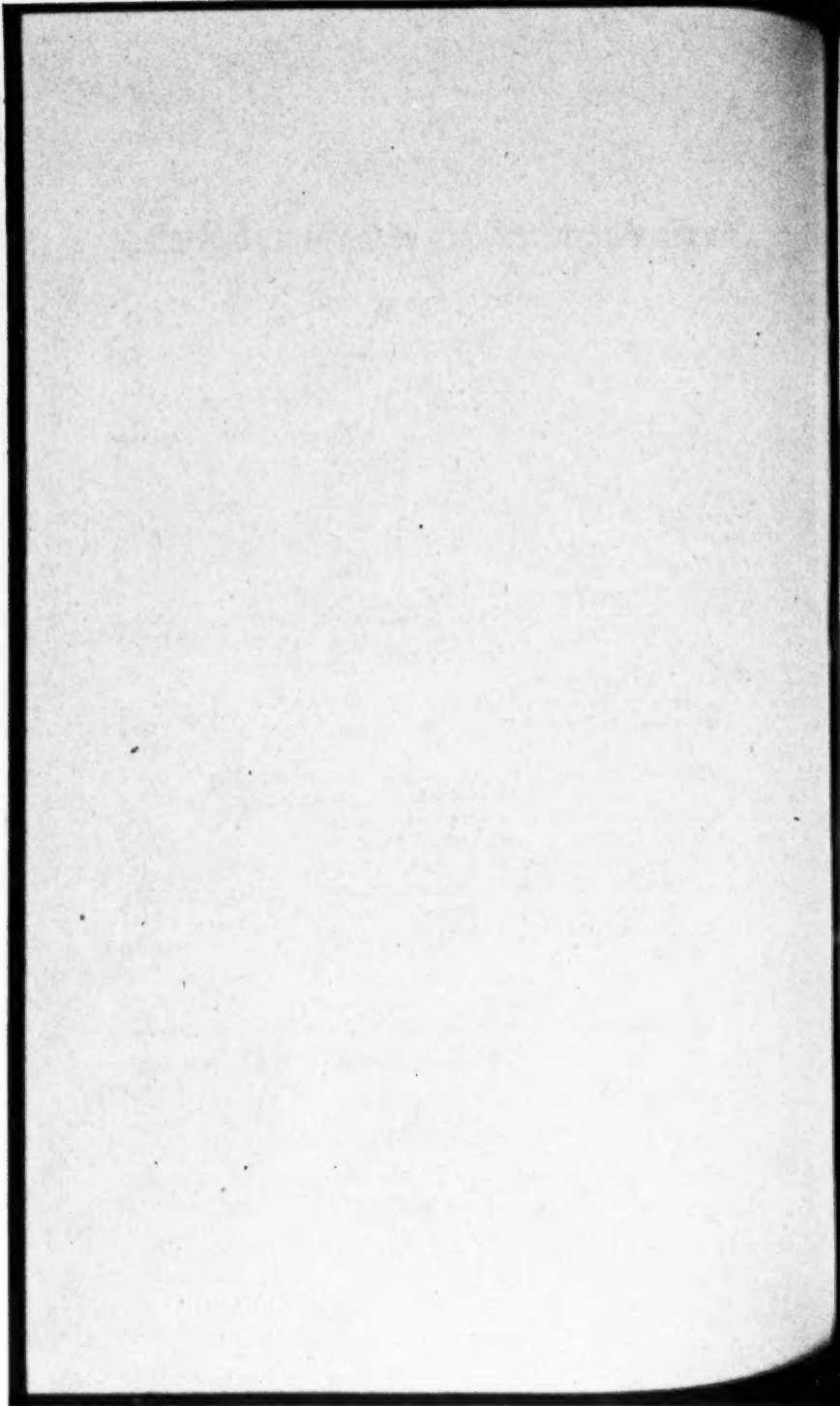
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In the Supreme Court of the United States

OCTOBER TERM, 1946

No. 401

THE BROOKLYN NATIONAL CORPORATION (IN
LIQUIDATION), PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE SECOND
CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 75-79) is reported at 5 T. C. 892. The opinion of the Circuit Court of Appeals (R. 89-94) is not yet reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered July 2, 1946. (R. 94.) The petition for writ of certiorari was filed on August 14, 1946. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the Tax Court erred in holding that the petitioner was subject, under Section 500 of the Internal Revenue Code, to the surtax on personal holding companies for the taxable year 1941, despite the facts (1) that the petitioner was not originally formed as such a company, and (2) that during the taxable year it was dissolved and paid liquidating dividends in excess of its 1941 subchapter A net income.

STATUTES INVOLVED

These will be found in the Appendix, *infra*.

STATEMENT

The facts, summarized from the Tax Court opinion (R. 75-77), are as follows:

The petitioner is a Maryland corporation organized in 1929. It filed a personal holding company return for the calendar year 1941. (R. 75-76.)

More than 50 percent in value of petitioner's outstanding stock was owned directly or indirectly by not more than five individuals during 1941. More than 80 percent of its gross income for the calendar year 1941 consisted of personal holding company income as defined in Section 502 of the Internal Revenue Code. (R. 76.)

The petitioner had no accumulated earnings or profits on January 1, 1941, but had a deficit at that time in the amount of \$72,100.29. Its operations during the taxable year resulted in a

net loss of \$30,518.06. One of the items entering into this loss was a net long-term capital loss of \$43,083.93. Its subchapter A net income for 1941, as defined by Section 505 (a) of the Internal Revenue Code, was \$4,367.80. (R. 76.)

Petitioner was engaged in the purchase, holding, and sale of securities, which business had not proved successful. Its stock was offered for sale to the public when it was organized in 1929. There were in the beginning about 500 stockholders, but this number was reduced by the petitioner's buying up of its stock until there were only 333 stockholders at the end of 1941. Petitioner's directors discovered in 1940 that more than 50 percent of the value of the outstanding stock was owned directly or indirectly by not more than five individuals. They realized that, as long as the capital was impaired, dividends could not be paid under the law, and that if dividends were not paid, the corporation might be taxed as a personal holding company. The stockholders adopted a resolution in November, 1941, dissolving the corporation and authorizing its liquidation, including the distribution of its assets, within three years from the date of the resolution. Articles of dissolution filed with the State Tax Commission of Maryland were approved on December 15, 1941. (R. 76.)

Petitioner paid liquidating dividends to its stockholders in the amount of \$133,980 in each of

the calendar years 1941, 1942, and 1943. The assets remaining at the end of 1943 consisted of cash in the amount of \$19,818.60, real estate of the value of \$5,965.38, and prepaid insurance of \$66.57. The sole asset of the corporation held at the end of 1944 was cash in the amount of \$25,685.64. (R. 77.)

The Tax Court held, one judge dissenting, that the Commissioner had correctly asserted a personal holding company surtax against petitioner for the year 1941. (R. 79.) The court below affirmed, Judge A. N. Hand, dissenting. (R. 89-94.)

ARGUMENT

Section 500 of the Internal Revenue Code (*infra*, p. 10) imposes a surtax upon "undistributed subchapter A net income of every personal holding company." Two questions are here presented: first, whether the taxpayer was a "personal holding company"; and second, even if it were a personal holding company, whether it had any "undistributed subchapter A net income."

1. Section 501 (a) (2), in defining a "personal holding company", specifies that at any time during the last half of the taxable year more than 50 per cent in value of its stock must be owned directly or indirectly by "not more than five individuals". It is true that the taxpayer herein, when originally organized in 1929, was not a personal holding company within the meaning of the

statute; but, as a result of the corporation's repurchase of a number of shares of its own stock, more than 50 per cent of its outstanding stock was owned by not more than five individuals during the taxable year 1941. Accordingly, there is full compliance with the statutory requirement. However, the taxpayer seeks relief from the statute on the ground that it was not organized or utilized for the purpose against which the statute was aimed. But the statute is satisfied where its terms are met; it does not require any investigation into the illusive subjective realm of motivation. The Tax Court so held, and none of the judges in the court below disagreed. The decision on this issue is plainly correct and certainly does not call for further review.

2. The surtax imposed upon a personal holding company by Section 500 is measured by its "undistributed subchapter A net income". In this case, it is undisputed that the taxpayer corporation had "subchapter A net income" in the amount of \$4,367.80 for the taxable year 1941. (R. 76, 77). "Subchapter A net income" is purely a statutory concept, and is computed in accordance with the directions set forth in Section 505, *infra*, p. 12. A corporation may have "subchapter A net income" as a result of limitations upon deductions in Section 505, even though it may not have any "net income". Such was the

case here for the year 1941; the Tax Court so held, and none of the judges in the court below disagreed.

The crux of this case is whether the subchapter A net income for 1941 was "undistributed" during that year. The taxpayer contends in effect that against its subchapter A net income there must be charged its 1941 distribution in liquidation (there were distributions in liquidation in the amount of \$133,980 in each of the calendar years 1941, 1942 and 1943), with the result that it had no "undistributed" subchapter A net income subject to tax. As the Tax Court pointed out, however, resort must be had to the statute in determining how much is "undistributed", and, under the statute, the "dividends paid" credit must be limited by Section 115 which defines "dividend". But the taxpayer's liquidating dividend failed to qualify as a dividend under Section 115 and was simply a distribution in liquidation which did not bring about any distribution of "earnings or profits" since the corporation had none to distribute.

The difficulty that may perhaps arise at first blush in this connection is due to the fact that the case involves technical statutory concepts such as "net income", "subchapter A net income", "dividend", and "earnings and profits". The Tax Court, however, scrupulously applied these statutory concepts in accordance with explicit statutory directions. The affirmance of its decision

was therefore correct, although it may be doubted whether the scope of review in the court below is as narrow as was indicated in Judge Learned Hand's opinion. Cf. *Trust of Bingham v. United States*, 325 U. S. 365.

In announcing that he felt bound to affirm the Tax Court's decision Judge Learned Hand indicated a preference for the earlier decision of the court below in *Pembroke Realty & S. Corp. v. Commissioner*, 122 F. 2d 252. But in the *Pembroke* case, the corporation did have current earnings which the distribution in question necessarily included since none of the assets were retained by the corporation beyond the tax year. Thus the ultimate purpose of Congress in enacting the personal holding company tax law was not defeated by permitting the Pembroke corporation to escape the surtax, for to the extent that the distribution was composed of earnings it was taxable in the hands of the distributees; that point is made in the *Pembroke* opinion (p. 254), and it was emphasized as a pivotal distinction in Judge Clark's concurring opinion herein. (R. 93.) The taxable income of the distributees was not increased in the least by the distribution in the case at bar—yet the corporation did indubitably have subchapter A net income.

In the circumstances, since the decision of the Tax Court herein was correct, and since the only basis for challenging that decision on this issue

was the *Pembroke* case which is distinguishable, further review of this case does not appear to be called for.

CONCLUSION

The petition for writ of certiorari should be denied.

Respectfully submitted.

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SEPTEMBER 1946.

APPENDIX

Internal Revenue Code:

SEC. 27. CORPORATION DIVIDENDS PAID CREDIT.

(a) *Definition in general.*—As used in this chapter with respect to any taxable year the term “dividends paid credit” means the sum of:

(1) The basic surtax credit for such year, computed as provided in subsection (b);

* * * *

(b) *Basic surtax credit.*—As used in this chapter the term “basic surtax credit” means the sum of:

(1) The dividends paid during the taxable year, increased by the consent dividends credit provided in section 28, and reduced by the amount of the credit provided in section 26 (a), relating to interest on certain obligations of the United States and Government corporations;

* * * *

(g) *Distributions in liquidation.*—In the case of amounts distributed in liquidation the part of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913, shall, for the purposes of computing the basic surtax credit under this section, be treated as a taxable dividend paid.

* * * *

(26 U. S. C. 1940 ed., Sec. 27.)

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of dividend.*—The term

“dividend” when used in this chapter (except in section 203 (a) (3) and section 207 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

* * * * *

(26 U. S. C. 1940 ed., Sec. 115.)

SEC. 500 [as amended by Section 110 (a) of the Revenue Act of 1941, c. 412, 55 Stat. 687]. SURTAX ON PERSONAL HOLDING COMPANIES.—There shall be levied, collected, and paid, for each taxable year beginning after December 31, 1938, upon the undistributed subchapter A net income of every personal holding company (in addition to the taxes imposed by chapter 1) a surtax equal to the sum of the following:

(1) $71\frac{1}{2}$ per centum of the amount thereof not in excess of \$2,000; plus

(2) $82\frac{1}{2}$ per centum of the amount thereof in excess of \$2,000.

(26 U. S. C. 1940 ed., Sec. 500.)

SEC. 501. DEFINITION OF PERSONAL HOLDING COMPANY.

(a) *General rule.*—For the purposes of this subchapter and chapter 1, the term “personal holding company” means any corporation if—

(1) *Gross income requirement.*—At least 80 per centum of its gross income for the

taxable year is personal holding company income as defined in section 502; but if the corporation is a personal holding company with respect to any taxable year beginning after December 31, 1936, then, for each subsequent taxable year, the minimum percentage shall be 70 per centum in lieu of 80 per centum, until a taxable year during the whole of the last half of which the stock ownership required by paragraph (2) does not exist, or until the expiration of three consecutive taxable years in each of which less than 70 per centum of the gross income is personal holding company income; and

(2) *Stock ownership requirement.*—At any time during the last half of the taxable year more than 50 per centum in value of its outstanding stock is owned, directly or indirectly, by or for not more than five individuals.

* * * *

(26 U. S. C. 1940 ed., Sec. 501.)

SEC. 504 [as amended by the Act of March 17, 1941, c. 21, 55 Stat. 44]. UN-DISTRIBUTED SUBCHAPTER A NET INCOME.—For the purposes of this subchapter the term “undistributed subchapter A net income” means the subchapter A net income (as defined in section 505) minus—

(a) The amount of the dividends paid credit provided in section 27 (a) without the benefit of paragraphs (3) and (4) thereof (computed without its reduction, under section 27 (b) (1), by the amount of the credit provided in section 26 (a), relating to interest on certain obligations of the United States and Government corporations); but, in the computation of the

dividends paid credit for the purposes of this subchapter, the amount allowed under subsection (c) of this section or of section 405 of the Revenue Act of 1938 in the computation of the tax under this subchapter or under Title IA of the Revenue Act of 1938 for any preceding taxable year beginning after December 31, 1937, shall be considered as a dividend paid in such preceding taxable year and not in the year of distribution;

* * * *

(26 U. S. C. 1940 ed., Sec. 504.)

SEC. 505 [as amended by Section 211 (i) and Section 212 (d) of the Revenue Act of 1939, c. 247, 53 Stat. 862].

SUBCHAPTER A NET INCOME.—For the purposes of this subchapter the term "Subchapter A Net Income" means the net income with the following adjustments:

(a) *Additional deductions*.—There shall be allowed as deductions—

(1) Federal income, war-profits, and excess-profits taxes paid or accrued during the taxable year to the extent not allowed as a deduction under section 23; but not including the tax imposed by section 102, section 500, or a section of a prior income-tax law corresponding to either of such sections.

* * * *

(c) *Net loss carry-over disallowed*.—The deduction for net operating losses provided in section 23 (s) shall not be allowed.

(d) *Capital losses*.—The net income shall be computed without regard to section 117 (d) and (e), and losses from sales or exchanges of capital assets shall be allowed only to the extent of \$2,000 plus the gains

from such sales or exchanges. (26 U. S. C. 1940 ed., Sec. 505.)

SEC. 507. MEANING OF TERMS USED.

The terms used in this subchapter shall have the same meaning as when used in chapter 1.